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081935Z Dec 05

UNCLAS SECTION 01 OF 03 CALGARY 000723

SIPDIS

STATE FOR WHA/CAN, EB/ESC/ISC, EB/PPD

USDOE FOR IA (DEVITO, PUMPHREY, DEUTSCH)

MOSCOW FOR TOM HUFFAKER

E.O. 12958: N/A

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SUBJECT: IMPERIAL MOVES TO REGULATORY HEARINGS, BUT COMMITMENT TO BUILD MACKENZIE PIPELINE WILL HAVE TO WAIT

REF: OTTAWA 3505

1. (SBU) Summary: After months of delay and uncertainty, Imperial Oil and its partners in the proposed Mackenzie Valley natural gas pipeline announced in November that they are ready to move to public hearings. While Imperial claims the announcement is "not a decision to build a pipeline", the move represents the first real step forward since Imperial cancelled preparatory work last spring, and opens the door for the National Energy Board (NEB) to begin its series of public hearings with stakeholders in the north. The NEB, in the meantime, has begun a two week pre-hearing conference in the Northwest Territories (NWT) that will provide information on the hearing process as well as information on the NEB's role throughout the lifecycle of the pipeline. Emphasizing sensitivities surrounding the project, NEB Chairman Ken Vollman recently told CG that the board was unable to discuss the specific "merits" of the project, but offered a general outline of the process and a timeline for conclusion of the hearings. In a separate meeting with CG, Imperial Oil's Senior VP expressed guarded optimism that the Mackenzie project will move forward. End summary.

Imperial Notes Mackenzie's Outstanding "Killer" Concerns

2. (SBU) CG and Econ Assistant met with Imperial Oil Senior Vice President Randy Broiles on December 6 to discuss the November 23 announcement that Imperial and its partners in the proposed C\$7 billion Mackenzie Valley natural gas pipeline - ConocoPhillips, ExxonMobil, Shell Canada, and the Aboriginal Pipeline Group (APG) - are ready to proceed to public hearings and seek regulatory approval from the Calgary-based National Energy Board (NEB). Broiles said the announcement is a positive move forward after partners halted work in April, but noted two "killer" concerns that remain. Broiles, a native Texan who came on board with Imperial in July 2005, said he has studied the project for the last five months describing it as "weak" economically. He noted that "forward" gas prices are the same today as two to three years ago, but investment in the project has jumped some 20%-30% during that same time. Costs from contracts, to equipment, to steel prices have risen, so all cost estimates for the project have risen accordingly. Broiles also expressed some concern with respect to the amount of gas reserves from the three anchor fields (Taglu, Parsons Lake, and Niglintgak) on which the project is based, suggesting that the reserves may not be enough to support the 30-inch diameter pipeline, designed to deliver 1.2 to 1.9 billion cubic feet of gas per day.

3. (SBU) Broiles said the second "killer" concern is the outstanding access and benefits agreements with First Nations located along the proposed 1220-kilometer route. Broiles said agreements have been reached with the Inuvialuit (led by former NWT Premier Nellie Cournoyer and which he describes as the most business savvy group), the Gwich'in, the Sahtu, the K'ahsho Got'ine and Tulita/Deline. The holdout in the equation is the Deh Cho, the only group along the route to not have a potential ownership stake and which, according to Broiles, is using the fact that it has no land claim agreement with the federal government as leverage through which to gain more benefits from project partners. Broiles pointed out that Ottawa and Imperial will negotiate simultaneously with the Deh Cho to reach land claims and benefits agreements, but the land claims agreement has clearly complicated and delayed dealings with Imperial. Deh Cho lands cover some 40% of the pipeline's route.

Imperial Welcomes Ottawa's "Fiscal" Assurances

4. (SBU) But Broiles noted the developments that helped partners reach their decision to move forward to the hearing process,

notably the welcome "assurances" partners received from the federal government. Broiles, who stated that Ottawa has less of an appetite for taxation and more for royalty changes, described Deputy Prime Minister Anne McLellan's recent proposal one of "preferred profit sharing". Broiles was referring to the Minister's letter of November 18, which outlined a fiscal and royalty structure proposal that would, firstly, see Ottawa accept royalties in kind with a commitment to ship on the pipeline; in other words, Ottawa would take its cut in gas rather than cash. Secondly, Ottawa would step in to guarantee shipping above the current 830 million cubic feet per day that shippers are comfortable backing. Thirdly, Ottawa would review a royalty regime where industry pays higher royalties when volumes of gas and prices are high, and lower royalties if volumes and prices dip. Lastly, Ottawa would offer to back the line with federal cash. Broiles had considerable praise for Minister McLellan stating that, were she to lose her seat in the upcoming federal election, "she would be missed". Broiles opined that, should that happen, support for the project would not change under a Conservative Party government.

15. (SBU) Broiles said an "optimistic" timeline for having the pipeline on-stream would be the end of 2011. Following some 18 months of hearings, construction would commence winter 2007 followed by two more years of winter construction. (As an aside, Broiles estimates public hearing expenses at some \$15-\$20 million per month beginning in 2006, given the company's "teams" (whether environmental and regulatory, etc.) that will be required to attend each of the NEB and Joint Review Panel (JRP) hearings throughout the NWT.) Broiles added that, should any unforeseen information be required by either the NEB or JRP, it could be enough to delay the project to perhaps give the proposed Alaska Pipeline project an advantage. While Broiles thinks that is essentially unlikely, he added it is not impossible.

16. (SBU) On that note, Broiles spoke of the controversy surrounding the proposed Alaska Pipeline project, including the federal government's impending decision on whether the Canadian portion of the line will fall under the jurisdiction of the NEB, favored by the pipeline's backers: ConocoPhillips, ExxonMobil and BP, or the Northern Pipeline Act (NPA), favored by Calgary-based TransCanada, which claims route exclusivity under a 1977 Canada-U.S. treaty. Broiles agreed with CG that the GOC is waiting for Alaskan officials to resolve fiscal negotiations with producers before making a decision. That decision will inevitably be further delayed by the upcoming Canadian federal election and a possible change in government. Broiles added that, should the Alaska pipeline proceed before Mackenzie, "costs will go sky high".

NEB Protects Sensitivity of Mackenzie Valley Public Hearings

17. (SBU) CG and Econ Assistant also met with Ken Vollman, Chairman and Gaetan Caron, Vice Chairman of the NEB on December 2 for a general discussion on the Mackenzie Valley public hearings. When post first contacted the NEB for an update on the project, we were told that the NEB could not specifically discuss its merits, given that the board was about to begin formal hearings. Vollman explained that two sets of hearings would be held in "a parallel fashion" beginning January 23, 2006: 1) regulatory hearings by the NEB, and 2) environmental hearings by the JRP. Vollman noted that regulatory hearings will address all issues other than environmental, including questions regarding "adequate gas supply" for the pipeline; whether contracts are in place; the design of the pipeline and its size, ie., the current proposal is some 30%-40% larger than what the natural gas fields can immediately supply; and permafrost, which Vollman claims is perhaps one of the most important issues to be addressed given that there is not much good information currently available on constructing pipelines that will be laid in a permafrost region. Vollman said he expects the JRP hearings to be completed and a report sent to the GOC by the end of 2006. NEB hearings would continue, and their report would be presented to the GOC by mid-2007. Following approval and, should the Producers' Group wish to proceed with the project, construction would commence for the 2007-2008 winter season, as noted above by Imperial.

18. (SBU) With respect to the Alaska pipeline and an NPA versus NEB jurisdiction, Vollman said that is strictly a policy decision, and the GOC appears prepared to let Alaska "sort their stuff out" first. Even after a Canadian federal election and a possible new government, a decision is not likely to be announced too quickly. That said, Vollman concedes that the GOC, nevertheless, has been "positioning itself" with respect to permitting and other administrative issues regarding the proposal. Both Vollman and Caron agreed that the actual NEB process would not be affected by movement, one way or the other, by the Alaska pipeline.

Comment

19. (SBU) Imperial's recent announcement may not mean a commitment to build, but all of our interlocutors and industry observers concede that it is, indeed, positive movement following last spring's setback. As Randy Broiles noted to us, a final decision to proceed will not be made by Imperial until it has had a chance to review the NEB's decision in 2007, the cost implications of any conditions/requirements implicit in the report. Tough challenges remain and they are formidable, most notably the obstacles presented by the lone holdout - the Deh Cho. While Imperial would have preferred to have all benefits and access agreements in place before the end of the year, the company acknowledges that it will likely take the "better part of a year" to reach a final agreement.

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